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H FOR MARK SMITH, PLEASE PASS CODEL COSTELLO
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SUBJECT: CROATIA: SCENESETTER FOR CODEL COSTELLO

¶1. You are coming to Croatia at an exciting time, as this young nation prepares to take its place among democratic, free-market members of the Euro-Atlantic community with a level of freedom, security, and prosperity that were unimaginable fifteen years ago. Croatia will very likely receive an invitation to join NATO next spring, is currently in accession negotiations with the EU and is proving itself an important ally in advancing the USG's regional and global interests.

REGIONAL AND GLOBAL CONTRIBUTOR TO STABILITY AND SECURITY

¶2. Just a decade ago, Croatia was a consumer of international security resources, with U.N. forces ensuring the peaceful reintegration of the eastern Slavonia region after the disintegration of the former Yugoslavia. Today, Croatia is an exporter of stability, both in the region and globally:

- as a strong, active partner in the Adriatic Charter, an initiative including Albania and Macedonia to promote democratic and defense reforms on the road to NATO integration;
- as a provider of soldiers and police to 11 UN peacekeeping missions from Kosovo to East Timor, with plans to contribute to five more;
- as a significant contributor to NATO operations, with a 198-troop ISAF contingent in Afghanistan (set to grow 300 in 2008), and liaison officers involved in Operation Active Endeavor, NATO's counterterrorism mission in the Mediterranean;
- as a host of NATO exercises, including the largest NATO civilian disaster response exercise ever held in a non-member state last May.

¶3. Croatia's constructive engagement within the region continues to be one of its greatest contributions to stability. This summer, Croatia hosted a high-level meeting on Southeast Europe in Dubrovnik and concluded its successful chairmanship of the South East European Cooperation Process in May with the formation of a permanent Regional Cooperation Council. In the past four years Croatia also has concluded several key regional agreements. For example, it signed the Central European Free Trade Agreement in 2006, bringing together the former Yugoslav republics (excluding Slovenia), Albania, Moldova and Kosovo together in an effort to bolster free trade relations among members and to strengthen WTO commitments and EU trade practices. We have also had an increasingly productive dialogue with Croatian leaders on Southeastern Europe's "unfinished business" in Bosnia and Herzegovina and Kosovo. Relations with Serbia remain sensitive, but President Stjepan Mesic and Prime Minister Ivo Sanader both have good relations with their counterparts in Belgrade and firmly support Serbia's future in

Europe and NATO.

COMMITMENT TO DEMOCRATIC VALUES

¶4. Croatia has come a long way since the 1990s, and the Government has focused particularly on democratic reforms, recognizing they have a significant impact on NATO and EU accession. Croatia has achieved concrete progress in key areas, with the majority of OSCE-related issues largely resolved. While judicial reform remains an area for further reforms, significant progress has been achieved: court backlogs are shrinking, and Croatian courts are trying war crimes cases in a fair manner without regard to ethnicity, including high-profile war crimes cases and cases transferred from The Hague Tribunal. Many countries have recognized this progress, most recently with the OSCE Chairman in Office calling for the closure of the OSCE mission by the end of the year.

¶5. On refugee returns, Croatia has welcomed back more than 125,000 refugees of Serb ethnicity and the Government has largely completed its programs of home repossession and reconstruction, infrastructure development, and has begun housing programs for former tenants of socialized apartments. In addition, it has agreed to meet by the end of 2007 specific benchmarks in consultation with the international community on outstanding issues relating to its housing program and to pension credit for years worked under the Serb administration.

¶6. Croatia is preparing for parliamentary elections this fall, with all major parties supporting platforms of Euro-Atlantic integration, increased anti-corruption initiatives, and continued market reforms. The two major parties, the ruling center-right Croatian Democratic Union (HDZ) and the left wing opposition Socialist Democratic Party (SDP) are roughly even in the polls, signaling a tight race to decide who will form Croatia's next government.

ZAGREB 00000750 002 OF 002

STEADY GROWTH, BRIGHT FUTURE

¶7. Croatia, together with Slovenia, was the economic engine of the ex-Yugoslavia, accounting for a large portion of the industrial output and hard currency revenues generated by its tourism sector. Damage and dislocation from the war, the ensuing collapse of the manufacturing and tourism sectors, combined with a mismanaged privatization effort during those years, crippled Croatia's economy. Political changes in 2000 brought with it economic reforms, with the first years of this decade showing increasingly positive economic trends.

¶8. Croatia's economy has enjoyed steady growth since 2000, led by strong tourism receipts (tourism makes up 20% of GDP), a buoyant construction industry and growing mortgage and consumer lending. Croatia's economy grew at a rate of 4.8 percent in 2006. New figures for the first quarter of 2007 show the economy growing at a brisk 6.9 percent. Unemployment, remains relatively high, but has trended steadily downward, dropping under 12% for the first time in ¶2006. The average monthly gross salary in early 2006 was about \$1,159. Although Croatia's per capita GDP of \$9,000 is high by regional standards and is reflected in a relatively high standard of living, faster growth rates will be essential to closing the gap between Croatia and its wealthier western European neighbors.

¶9. The opening of EU accession talks in 2005 brought new confidence in Croatia's economic future, particularly as the Government has been forced to implement long-overdue reforms. Nevertheless, some significant problems still remain. Corruption, lack of transparency, an inefficient judiciary and an overly-large state role in the economy continue to hamper Croatia's growth. Croatia has made important improvements in its business climate in recent years, but more remains to be done to realize the Government's strategy of boosting foreign investment and quickening the pace of economic growth.

DUBROVNIK WILDFIRES

¶10. Dubrovnik suffered enormous damage during the war - both to its

historic buildings and its tourism base. After a long recovery and much restoration, Dubrovnik has regained its place as a top European vacation and cruise ship destination, attracting hundreds of thousands of tourists each summer. Smoke was back in the air this August, however, as local officials focused their attention on fighting wildfires in the mountains surrounding the walled city. The USG provided \$50,000 in emergency funding through the Office of Foreign Disaster Assistance.

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